

SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Lempert Analyst: Jeani Brent Bill Number: AB 2095

Related Bills: See Prior Analysis Telephone: 845-3410 Amended Date: 04/10/2000

Attorney: Patrick Kusiak Sponsor:

SUBJECT: Scholarshare Trust Contribution Credit/FTB Report Annually to Legislature Regarding Utilization of Credit

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

☒ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced February 22, 2000.

☒ FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO _____.

☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 22, 2000 STILL APPLIES.

☒ OTHER - See comments below.

SUMMARY OF BILL

Under the Personal Income Tax Law (PITL), this bill would allow taxpayers a credit equal to a specified percentage, not to exceed \$200 per qualified beneficiary, for contributions by a qualified taxpayer to a Scholarshare trust made on behalf of any qualified beneficiary.

This bill also would require the department to report, to the extent data is available, on the utilization of the credit allowed under the bill.

SUMMARY OF AMENDMENT

The April 10, 2000, amendments removed the bill's provisions that would have allowed a deduction for contributions to a Scholarshare trust and replaced them with the provisions discussed in this analysis.

Except for the items discussed in this analysis, the department's analysis of the bill as introduced still applies.

EFFECTIVE DATE

This bill would be effective immediately and would apply to taxable years beginning on or after January 1, 2000, and before January 1, 2005.

SPECIFIC FINDINGS

This bill would allow taxpayers a credit equal to a specified percentage based on the taxpayer's adjusted gross income (AGI), not to exceed \$200 per qualified beneficiary, for contributions by a qualified taxpayer to a Scholarshare trust made on behalf of any qualified beneficiary.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Legislative Director

Date

Johnnie Lou Rosas

4/27/00

"Qualified beneficiary" would include only those individuals for whom a Scholarshare account has been established and who are eligible to be claimed as a dependent on the taxpayer's tax return.

The credit would not be allowed for any expenses for which a deduction also is allowed.

Since **this bill** does not specify otherwise, the general rules in state tax law regarding the division of credits among taxpayers who share in the costs would apply.

This bill would allow any unused credit to be carried over until exhausted.

This bill would impose a 10% penalty on withdrawals that do not constitute qualified higher education expenses, as defined.

This bill would require the Scholarshare Investment Board to report to the department the amount of annual contributions and the point in time at which the contributions have reached the maximum level. The bill would require the department to report on the utilization of the credit allowed under the bill.

Policy Considerations

Pursuant to discussions with the author's staff, the department understands that the author intends this credit to be refundable. The attached amendments would include the language necessary to allow any credit in excess of tax liability to be refunded to the taxpayer.

If this bill is amended to be refundable and appropriations are made to pay the refundable portion (such as the line item appropriations for the renters' credit when it was refundable), this credit might be viewed as a "state public benefit" under the category of "post secondary education benefit." If it is a "state public benefit," federal law (Title IV, P.L. 104-193) requires states to deny the benefit to aliens other than qualified aliens or to enact legislative language affirmatively granting the "benefit" to all aliens.

Implementation Considerations

Department staff has identified the following implementation considerations raised by the bill as written. Pursuant to discussions with the author's staff, the attached amendments would resolve these concerns.

1. The phrasing of the credit amounts is unclear and does not reflect the intended calculation. The attached amendments would reflect the author's intent that the credit should be a specified percentage of the amount contributed, not to exceed \$200 per beneficiary, and that the allowable percentage should be based on AGI.
2. The bill currently would limit the credit to taxpayers who can claim a beneficiary as a dependent on their state tax return. The attached amendments would remove this restriction and ensure that the credit is allowed to any individual who makes contributions on behalf of a qualified beneficiary as defined under current law.

3. The bill would include head of household filers in the AGI limitations set for individual filers. The attached amendments would include them in the joint filer AGI limitations, which is how tax law is generally structured.
4. The provision that would impose a penalty for withdrawals from a Scholarshare trust account would be better placed with provisions related to the Scholarshare trust account rather than with provisions related to a credit for contributions to a Scholarshare trust account. Pursuant to the author's staff, the attached amendments would remove the penalty provision from the tax credit.
5. The attached amendments would change the operative and sunset dates to apply to the transaction instead of the taxpayer's taxable or income year and would delete the repeal date. This change would, pursuant to the author's staff request, ensure that after the credit itself sunsets the credit language would remain in the law.
6. The attached amendments would revise the provision for the Scholarshare Investment Board to report to the department. The amendments would more clearly specify the type of information needed by the department to verify the credit.

If this bill is amended to make the credit refundable, the bill would raise the following implementation considerations:

1. The department has not administered a refundable tax credit under the PITL since the refundable renter's credit was suspended in 1993. Establishing a refundable tax credit program would have a significant impact on the department's programs and operations and would require extensive changes to forms and systems.
2. Historically, refundable credits (such as the state renter's credit, the federal Earned Income Credit and the federal credit for gasoline used for farming) have had significant problems with invalid and fraudulent returns.
3. The department would need some time to develop adequate programs and operations to mitigate the potential for fraud and to ensure taxpayers receive the refund amount they are due. However, the operative date of this bill (applying to taxable years beginning on or after January 1, 2000) would make it difficult for the department to put in place necessary programs prior to the time taxpayers could file returns claiming the refund. Specifically, if this bill is enacted in late September 2000, taxpayers could begin filing returns claiming the refund as early as January 2001.

Technical Considerations

The amendments would make clear that the report from the department would be made to the Legislature.

The amendments would delete the provision that would deny the credit if a deduction is allowed for the same expense, since the contribution for which the credit is allowed is not an expense and no deduction is allowed for contributions.

LEGISLATIVELY MANDATED REPORTS

This bill would require the department to report, to the extent data are available, on the utilization of the credit allowed under the bill.

FISCAL IMPACT

Departmental Costs

If the bill is amended to resolve the implementation considerations addressed in this analysis, the department's costs are expected to be minor.

However, if this bill is amended to make the credit refundable, the department's costs to administer the bill would be as follows:

The costs for the department to administer this bill if it is amended to make the credit refundable are estimated to be \$87,871, including one time implementation costs of \$78,812, for fiscal year 2000 and would increase each year as volumes increase until they reach a maximum of \$267,777 in 2007. It is estimated that this bill would require the department to incur one additional personnel year (PY) in 2000, increasing to a total of 6.1 PYs in 2007.

The costs were calculated using the following assumptions based on information the department received from TIAA-CREF Tuition Financing, Inc., which manages the Golden State Scholarshare program.

- Population of taxpayers would start at 27,000 in 2000 and increase to approximately 350,000 in 2007.
- All filers claiming this credit are assumed to be taxpayers who currently file a return. It is not anticipated that this credit would encourage persons who do not currently file to file just to claim the credit.

Note that if the refundability of this credit results in the credit being a "state public benefit" as discussed in "Policy Considerations" above, the departmental costs to administer the bill could be considerably greater.

Tax Revenue Estimate

Based on limited data and assumptions discussed below, this bill would result in the following revenue losses under the PITL. The author's staff has expressed intent to have the proposed credit be a refundable credit. Therefore, estimates are provided for the proposed credit if nonrefundable and if refundable.

Estimated Revenue Impact of AB 2095 As Amended 4/10/00 and with FTB Proposed Amendments [\$ In Millions]			
Proposed credit:	2000-01	2001-02	2002-03
If non-refundable	(\$3)	(\$8)	(\$14)
If refundable	(\$3)	(\$9)	(\$15)

Estimates assume the bill would be effective with contributions made on or after January 1, 2000, with enactment assumed after June 30.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

As a nonrefundable credit, the amount of Scholarshare contribution credits that could be applied to reduce tax liabilities would determine the revenue impact of this bill. As a refundable credit, the amount of credits generated and reported on tax returns would determine the revenue impact.

For these estimates, the number of accounts for qualified beneficiaries was projected as 27,000 in 2000 and growing to nearly 200,000 by year-end 2004.

For the estimate of a nonrefundable credit, tax data was used to calculate a rate at which credits could be applied to reduce tax liabilities.

Liability year estimates were converted to cash-flow estimates above. Cash-flow estimates reflect the ability of some taxpayers to accelerate tax benefits by adjusting their estimated tax payments.

The launch date for the Golden State Scholarshare program was October 4, 1999. As of April 7, 2000, contributions totaled \$45.2 million for the benefit of 9,103 beneficiaries. Dividing the \$45.2 million by 9,103 accounts indicates a simple average contribution of \$4,965 per beneficiary. Based on information from TIAA-CREF Tuition Financing, Inc., which manages the Golden State Scholarshare program, the simple average contribution above is skewed high because of some huge sums contributed to a few new accounts. Based on TIAA experience managing other states' tuition financing programs, first-year contributions generally average on the order of \$3,000 per account.

The number of qualified beneficiaries was estimated at 27,000 by year-end 2000. This estimate is higher than that used in the department's revenue estimate for the bill as introduced. The new estimate is based on actual data to date for the Scholarshare trust. Data indicate that the number of new accounts opened each month is increasing on average an additional 10% over that of the previous month. Future vintages of new accounts are assumed to grow 15% in 2001 and 10% annually thereafter. Additional growth was phased-in to account for the incentive effect of the proposed credit.

Tax return data were used to distribute projected accounts for qualified beneficiaries by filing status and AGI class of taxpayers. Head of household filing status was included with married filing joint, as the author staff indicated. For each AGI class, average contributions were estimated at 5% of the mid-point AGI. To reflect the author's intent that the credit should be a specified percentage of the amount contributed, average contribution amounts were multiplied by specified credit percentages to derive an average credit for each AGI class. Average credit amounts are grown from one year to the next by 3% to represent future growth in income of eligible taxpayers.

Credits for all vintages were summed. Total credits were increased an additional 10% to account for the author's intent to provide the credit to any individual making a contribution on behalf of any qualified beneficiary. Finally, allowances were made for the percentage of credits that would be reported and, as a nonrefundable credit, the percentage of credits applied.

BOARD POSITION

Pending.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 2095
As Amended April 10, 2000

AMENDMENT 1

@@@Leg. Counsel: Please modify Section 1 of the bill as follows:

SECTION 1. Section 17053.60 is added to the Revenue and Taxation Code, to read:

17053.60. (a) ~~For each taxable year beginning~~ There shall be allowed as a credit against the "net tax," as defined in Section 17039, of an individual, as defined in Section 17005, an amount determined under subdivision (b) for any contribution made on or after January 1, 2000, and before January 1, 2005, there shall be allowed as a credit against the "net tax," as defined by Section 17039, an amount, not to exceed two hundred dollars (\$200) per each qualified beneficiary, equal to the amount determined pursuant to subdivisions (b) and (c) of any contribution during the taxable year by a taxpayer to a Scholarshare trust, as defined by subdivision (i) (f) of Section 69980 of the Education Code, made on behalf of any qualified beneficiary.

(b) (1) ~~For joint filers married couples filing joint returns and heads of household,~~ the credit shall be the following amounts, subject to the limitation provided in paragraph (3), based upon the following adjusted gross income for the taxable year:

The adjusted gross income is:

The credit is:

Less than \$35,000

10% of ~~adjusted gross income~~ the amount contributed

\$35,000 or more, but less than
\$100,000

5% of ~~adjusted gross income~~ the amount contributed

\$100,000 or more, but less than
\$150,000

2% of ~~adjusted gross income~~ the amount contributed

\$150,000 or more

0

~~(c)~~

(2) For other individuals, other than joint filers the credit shall be the following amounts, subject to the limitation provided in paragraph (3), based upon the following adjusted gross income for the taxable year:

If the adjusted gross income is:

The credit is:

Less than \$17,500

10% of ~~adjusted gross income~~ the amount contributed

\$17,500 or more, but less than
\$50,000

5% of ~~adjusted gross income~~ the amount contributed

\$50,000 or more, but less than	2% of adjusted gross income <u>the amount</u>
\$75,000	<u>contributed</u>
\$75,000 or more	0

(3) The amount of the credit allowed pursuant to this section shall not exceed \$200 for contributions made on behalf of each qualified beneficiary during each taxable year.

(d) For purposes of this section, "qualified beneficiary" means an individual for whom a Scholarshare account has been established and who is eligible to be claimed as a "dependent" on the taxpayer's tax return. has the meaning set forth in subdivision (c) of Section 69980 of the Education Code.

~~(e) No credit shall be allowed by this section for any expenses for which a deduction is also allowed under this part.~~

~~(f) A penalty of 10 percent shall be imposed on withdrawals for any amounts that do not constitute qualified higher education expenses, as defined by Section 69980 of the Education Code.~~

~~(g)~~

(e) The Scholarshare Investment Board shall ~~report~~ provide an annual listing to the Franchise Tax Board ~~regarding (1)~~ (preferably on magnetic tape or other machine-readable form, and in a form and manner agreed upon by the Franchise Tax Board and the Scholarshare Investment Board) of the names and taxpayer identification numbers of taxpayers who made contributions and the amount of annual contributions made on behalf of a beneficiary and (2) the point in time where the amount of contributions made for a beneficiary have reached the maximum level of contributions as defined by the Scholarshare Investment Board.

~~(h)~~

(f) The Franchise Tax Board shall report annually to the Legislature, to the extent data is available, on the utilization of the credit allowed by this section.

~~(i)~~

(g) In the case of a taxpayer whose credit provided under this section exceeds the taxpayer's tax liability computed under this part, the excess shall be credited against other amounts due, if any, from the taxpayer and the balance, if any, shall be refunded to the taxpayer. In the case where the credit allowed by this section exceeds the "net tax," the excess may be carried over to reduce the "net tax" in the following year, and succeeding years if necessary, until the credit is exhausted.

~~(j) This section shall remain in effect only until December 1, 2005, and as of that date, is repealed.~~